or greater than long run incremental costs."[33/] Without established and enforced Commission principles regarding the assumptions and methodologies that must be used to calculate those long run incremental costs, however, NYNEX's "one constraint" becomes "no constraint at all" on the process used by the BOCs to set rates for BSEs.

5. Are the BellSouth and US West overhead loadings excessive?

The Commission's Investigation Order identified both BellSouth and US West as potentially having excessive BSE overhead loadings. As Attachment A of the Order reveals, both carriers allocated significantly more overhead to their BSEs than did the other BOCs. For example, for its Automatic Number Identification ("ANI") BSE,[34/] BellSouth used an overhead loading of 2.1667. (In other words, if BellSouth's ANI overhead loading was divided by its ANI direct cost, it would result in a ratio of 2.1667.) Similarly for ANI, US West has a ratio of overhead loadings to direct cost of 1.3396.[35/] Thus, remarkably, for BellSouth and US West, the direct costs of their BSEs were less than 50 percent of the tariffed rate. No other carrier had more than 38 percent of its

---

[33/] Id. at A-5.

[34/] Identified as Calling Billing Number Delivery in Attachment A.

[35/] See Attachment A.

overall BSE rate generated by overhead loading.[36/]

In defense of its overhead loadings, BellSouth responds in two ways. First, it explains that it has calculated its overhead loadings as a ratio of total local switching revenues to total local switching long run incremental costs, which is then applied uniformly to all BSEs. With its use of a local switching factor, BellSouth argues that,

> rates for new services are established in the same relationship to their incremental costs as are the existing local switching services priced with respect to their incremental costs. Clearly, this cannot be excessive if this is the existing relationship of the related, i.e. local switching Price Cap services.[37/]

After explaining how its overhead loading are calculated, BellSouth then attempts to justify why its loadings may differ from that of the other BOCs. According to the carrier, loadings may differ for several reasons. First, BOCs may be using different cost methodologies to identify direct costs. In addition, BOCs may choose different rate levels under price caps to respond to their differing market considerations. Finally, loadings may differ because the loading methodologies themselves may mix embedded cost methodologies and forward-looking cost methodologies. To BellSouth, differences between BOC overhead loadings are not important. Instead, the Commission should focus on the methodology

---

[36/] Id.

[37/] BellSouth Direct Case at 33-34.

adopted by each BOC, and ensure that each is reasonable in and of itself.[38/]

US West makes similar claims as Bell Atlantic. It reassures the Commission that "[t]he fact that ...[its] overhead loadings differ from other BOCs does not imply that they are unreasonable."[39/] And, although its overhead allocation may be relatively high, its BSE prices compare favorably to the other BOCs, suggesting that different pricing methodologies were used to develop overhead loadings.[40/]

The responses of BellSouth and US West further point out the problems MCI has identified in the ONA process. First, because the Commission has permitted the BOCs to develop their own individual costing methodologies to develop BSE rates, BOCs are permitted to develop overhead loadings which can vary dramatically from carrier to carrier. Thus, even when a carrier may have the lowest level of direct costs for a BSE, (for example BellSouth for its ANI BSE) it can load so much overhead into its rates, that the actual direct costs for its service become virtually meaningless.[41/] Therefore, any overhead comparisons between BOCs becomes an exercise in

---

[38/] Id.

[39/] US West Direct Case at 8.

[40/] Id.

[41/] See In the Matter of ONA Access Charge Tariff Filings, MCI Petition To Reject Or, In The Alternative, To Suspend And Investigate, filed November 26, 1991, at Exhibit 2.

futility, as each will develop overhead allocations based on marketing rather than cost considerations.

Second, as explained earlier, the SCIS costing model provides ample freedom for the BOCs to manipulate the "actual" costs of their BSEs to ensure that final BSE tariffed rates will be based on "costs" that can provide suitable justification for rates that are in actuality set to meet corporate marketing goals.

Finally, as BellSouth correctly points out, price caps provides a range of pricing levels for BOC services, allowing them for example, to increase local switching rates because they are non-competitive, and reduce local transport rates because of potential future competition. While pricing behavior such as this is lawful under the current regulatory mechanism, it unfortunately allows LECs the flexibility and justification needed to price new monopoly services at excessively high levels without fear of lost revenues.[42/] That is why it is extremely important, if ONA is to meet the Commission's stated objectives, that the Commission insist that appropriate cost-based pricing principles be employed in the pricing of ONA services.

In the case of ONA BSEs, all three of the factors discussed

[42/] See In The Matter Of Amendments Of Part 69 Of The Commission's Rules Relating To The Creation Of Access Charge Subelements For Open Network Architecture, Policy and Rules Concerning Rates For Dominant Carriers, CC Docket Nos. 89-79, 87-313, MCI Petition for Partial Reconsideration, filed September 21, 1992.

above are in evidence. The freedom to utilize individual costing methodologies has permitted BOCs to develop costs in a variety of methods, resulting in direct costs for the same service that vary from BOC to BOC by more than 1,000 percent. Second, the decision to keep significant aspects of the BOC costing models proprietary allows the BOCs the autonomy to develop costs that cannot be conclusively repudiated. Finally, the freedom to develop rates for new services under price caps has led to excessive rates for many BSEs, effectively eliminating any BSE demand by ESPs, and reducing the risk of ESPs providing any meaningful competition for the BOCs.

6. Have Carriers adequately justified their use of nonuniform overhead loadings in pricing BSEs?

All carriers have used uniform overhead loadings with the exception of Pacific's Network Reconfiguration Service ("NRS"). Pacific argues that it is appropriate to have differing overhead loadings for NRS because it develops cost factors and overhead loadings by product category, and NRS is a special access service, while all of its other BSEs are switched access services.[43/]

MCI believes that Pacific is simply reflecting pricing behavior used by all the LECs under price caps for a wide range of services, not just for BSEs. Under the current regulatory scheme, LECs have the flexibility to allocate overhead loadings to ensure

---

[43/] Pacific Direct Case at 7.

that less competitive services will proportionately contribute the greatest amount of overhead. The Commission's recent decision to find lawful any overhead loading for a new service as long as the price is lower than the service it is replacing,[44/] will add to that flexibility and exacerbate the potential for future BSEs to be excessively priced. As MCI has noted in its comments on the new services standard, this significant loosening of regulatory constraints is not in the public interest. In addition, even a requirement of uniform loadings is not sufficient to regulate LEC pricing, since it fails to eliminate LEC manipulation of BSE direct costs.

7. Are differences between BSE rates and unit cost differences justified?

Only NYNEX has priced any of its BSEs above its unit cost, and only in a single instance. NYNEX claims that it priced its Three Way Calling Service well above its cost for two reasons. First, NYNEX asserts that it set its Three Way calling rate at the same level of its intrastate Three Way Calling Business rate to avoid adverse effects of arbitrage. Second, NYNEX contends that if interstate rates were set below state rates, NYNEX would fail the

---

[44/] In The Matter Of Amendments of Part 69 Of The Commission's Rules Relating To The Creation Of Access Charge Subelements For Open Network Architecture, Policy And Rules Concerning Rates For Dominant Carriers, CC Docket Nos. 89-79, 87-313, Memorandum Opinion & Order On Second Further Reconsideration, FCC 92-325, released August6, 1992 ("New Services Reconsideration Order").

net revenue test for new services.[45/]

MCI believes however, that both contentions do not justify above cost pricing. The net revenue test clearly can no longer be a justification for pricing since it was eliminated in the New Services Reconsideration Order on August 6, 1992.

In addition, NYNEX has provided no justification or support for its claim that arbitrage would occur if interstate Three Way Calling was priced at cost. Moreover, as noted by AT&T in its petition seeking suspension of the BOC ONA tariffs, the Commission has recently reiterated that the Communications Act provides it exclusive jurisdiction to regulate the terms, rates and conditions of interstate communications services.[46/] Therefore, even if offering cost-based interstate Three Way Calling rates would impinge on the states regulatory domain, those regulatory bodies cannot "dictate the terms of interstate access services offered by NYNEX."[47/]

III. MCI'S NON-PUBLIC EVALUATION OF THE BOC COSTING PROCESS

[45/] NYNEX Direct Case at Appendix A, pp. 6-7.

[46/] See, Operator Services Providers Of America, 6 FCC Rcd 4475, 4476-77 (1991).

[47/] In The Matter Of ONA Access Charge Tariff Filings, AT&T Petition For Suspension And Investigation, filed November 26, 1992 at 20, n. *.

MCI participated fully (at least to the limited extent ratepayers were authorized by the Commission to participate) in the non-public portion of this proceeding in an attempt to determine the validity of the BOC's costing process as conducted, and, to the extent possible, determine the potential for this process to be exploited in a way that could allow "costs" to be generated to support predetermined anticompetitive pricing strategies. To that end, MCI has evaluated the mechanized cost models as provided under Redactions I and II. Also, MCI has also evaluated the Report of Arthur Andersen to the Commission (hereafter, the "Andersen Report").

The SCIS model is a computer-based costing tool developed by Bellcore and used by each of the BOCs to develop the cost support for the BSE rates filed in the BOC tariffs.[48/] As part of a larger cost development process, SCIS is a mechanized model for processing the input information supplied by the BOC analyst performing the cost study, and as with any mechanized model, the accuracy of the results is dependent on the quality and accuracy of the inputs. In order to validate the BOC costing process, therefore, it is necessary to evaluate two key areas:

> First, does the mechanized model, through its pre-programmed equations and algorithms, produce outputs that accurately reflect, given the input data provided, the underlying

---

[48/] US West uses both SCIS and its own SCM model to develop BSE costs. Because the models are conceptually and functionally similar, MCI's concerns regarding the use of SCIS will generally also apply to SCM.

investment[49] required of the BOC to produce the switching feature or function in question? In other words, given a valid set of inputs, is the internal processing accuracy of the model sufficient to ensure valid outputs?

And of equal importance, if the output of the model is found to be sensitive to the initial assumptions and input values used, are the values of these inputs reliably developed and verified to ensure that the final results of this process represent the best possible estimate of the BOC's cost to provide the feature? In other words, does this process give the cost analyst the potential to select from a range of unverified input values, known to affect output values in significant and predictable ways, so that a BOC's strategically-developed rates can be justified as "cost-based?"

It is MCI's position that even if there is reasonable assurance that the model performs its internal calculations without introducing significant error, the possibility of introducing error into the process exists at the non-mechanized points of the process. At these points, the analyst must select a large number of essential input values; a process that is not documented by the BOCs and which was not evaluated in the Andersen Report. If the values assigned to these inputs, or the relationships among the values of several inputs, are found to affect the model's output in a systematic way, then the Commission cannot be assured that the BOC cost support developed through this process constitutes effective protection against anticompetitive pricing.

In order to provide the Commission with data useful in determining the degree to which the potential for such misuse of

---

[49]It is important to note that SCIS and SCM outputs are stated in terms of investment; costs based on these investments are calculated external to the model.

the costing process exists, MCI acquired a "redacted" copy of the SCIS software and documentation under the terms and conditions established. The non-disclosure agreements prescribed by the Commission and executed by MCI as a condition precedent to obtaining any access whatsoever to the BOC cost models imposed substantial restrictions on the use to which the information could be put by intervenors, as well as restricting the number of individuals representing each intervenor that would have access to either the software or the documentation. These restrictions went far beyond those reasonably required to satisfy Bellcore's interest in protecting its intellectual property and to protect the switch manufacturers from disclosure of technical and cost information related to their products. Even after MCI executed these onerous non-disclosure agreements, the materials provided for review were redacted to such a degree as to make them unfit for any meaningful examination.[50/]

As MCI described to the Staff at that time,[51/] most of the redactions made to both the software and the documentation appear to have been made for the purpose of preventing intervenors from

---

[50/]As an example of the overzealous nature of the redactions performed, Bellcore chose to remove general information regarding the functioning of the SCIS model from the materials provided subject to the proprietary agreements, even though it had recently provided identical materials - on a non-proprietary basis - in similar state investigations.

[51/]For a complete description of MCI's concerns regarding Redaction I, please see MCI's March 9, 1992 letter to Stanley P. Wiggins contained in the public record.

using and understanding the model, rather than to protect the proprietary data of the switch manufacturers. Specifically, the formats of the model's input screens, designed to assist the user in data entry, were modified to make the successful entry of input data, even on a trial-and-error basis, nearly impossible. The documentation of the calculations, equations, and descriptions of variables - essential to an understanding of the model but unrelated to the proprietary data of the switch manufacturers - were removed, even when the values initially present were clearly labeled "for illustrate purposes only and not to be interpreted as typical values." This type of redaction allows an intervenor to observe, but makes it nearly impossible to document, the wide latitude that the cost analyst enjoys when selecting input values to the model.

Even an experienced SCIS user who is familiar with the input screens in their original form would not have been able to successfully perform a series of "runs" of the model in order to determine the sensitivity of SCIS outputs to variations in these input values, however. In place of the actual values of the "table data" switching characteristics, Bellcore (reportedly because the switch manufacturers insisted that proprietary data be withheld from intervenors notwithstanding the extensive protections provided by the non-disclosure agreements prescribed by the Commission) substituted "randomized" (rather than masked or otherwise hidden) values in the version of the model provided to intervenors. As a

result, an intervenor who persevered long enough to decode the various mutations of the input screens was ultimately rewarded with meaningless output values.

Finally, MCI observed in its evaluation of the Redaction I materials that US West's SCM model had been provided with its "sensitivity function" disabled. While it is unclear why such a function would need to be disabled in order to protect the proprietary information of the switch manufacturers, it is even more unclear why, in a model designed to take cost inputs as they independently exist and calculate an output value, a "sensitivity function" need be designed into the model, presumably at some expense. An analyst faced with the task of finding input values would generate cost estimates necessary to support a predetermined BSE rate, however, would obviously find such a function highly useful.

In order to make more useful information available to intervenors, Redaction II was ordered by the Commission. While the "randomized" data from Redaction I was reportedly presented as actual data in Redaction II, other changes were also made to both the software and documentation. Specifically, elements essential to the functioning of the model were removed or masked, again making meaningful evaluation of the model by intervenors, including sensitivity analysis, impossible. According to Bellcore's July 13, 1992 ex parte letter to the Commission comparing twenty-one

elements across Redaction I and Redaction II, four potentially positive (i.e., additional disclosure, less redaction) changes were made, eight negative (i.e., less disclosure, additional redaction) changes were made, and nine of the listed elements were not changed. Clearly, in order for intervenors to perform a meaningful analysis of the SCIS costing process, and to provide the Commission with data useful in its evaluation of the BOC's costing methods and the potential for misuse, it is essential that a minimum set of elements be present in the same redaction. Without access to such a minimally functional model, the participation of intervenors in this portion of the proceeding is limited to providing a listing of well-documented suspicions regarding the potential for misuse of the costing process by the BOCs. While both "motive" and "method" can be readily established, an evidentiary showing by intervenors of "opportunity" was successfully thwarted by Bellcore in Redactions I and II under the guise of "protection of vendor proprietary information."

The procedures adopted and employed by the Bureau in the course of this tariff investigation have undermined intervenors' rights to meaningfully participate in the review of the BOCs' initial ONA access tariffs. There is something clearly wrong with the process when the Bureau is willing to meet behind closed doors with the BOCs, Bellcore and the switch manufacturers to determine what intervenors will and will not be permitted to see, but, at the same time, is unwilling to recommend prompt action on MCI's

Application for Review seeking (among other things) clarification that intervenors may "compare notes" on the precious little information they are permitted to see.[52/]

Fortunately (although it is incomplete in many areas), the Andersen Report demonstrates that such opportunity for misuse exists.[53/] Generally stated, the contents of the Andersen Report support the following conclusions:

1. When using SCIS and SCM, the cost analysts running the model have considerable input and costing choices; these parameters ultimately determine the service or feature investments produced as output by the models. These choices include a wide array of company-specific data assumptions, and changes in these input parameters can be used to create variation in the model results.

2. The sensitivity analysis performed by Andersen describes the

---

[52/] The Bureau's inaction on MCI's Application for Review concerning information sharing apparently emboldened Bellcore and the BOCs to impose even more onerous restrictions on the intervenors' access to Redaction II. That is, the BOCs insisted that intervenors execute a "Notice of Compliance" pledging that they would not discuss the contents of Redaction II with other intervenors as a condition precedent to review of Redaction II.

[53/] Although useful in this specific context, the contents of the Andersen report have limited value in a more general evaluation of the BOC costing process for two reasons. First, the Andersen review focuses primarily on the question of whether the SCIS model makes accurate internal calculations given a set of specified inputs. While the flexibility enjoyed by the analyst when choosing among possible input values and relationships is acknowledged in the Report, Andersen conducted no investigation into the methods used to determine input values, and did not attempt to ascertain whether the BOC costing process based on the SCIS model had or could be used to support a predetermined rate. Second, the data, sensitivity analysis results, and conclusions of the Andersen review remain subject to nondisclosure agreements. As a result, MCI's arguments in this section are restricted to general descriptions. Specific cites to the Andersen Report are contained in Appendix A to this pleading, which is being filed under protective cover.

effects of changes in these input parameters to the overall variation in reported costs. Of the six categories of BOC-controlled input parameters evaluated, all six were described as significant or consistently important to the reported output of the model.

The latitude available to the BOC cost analyst when selecting the assumptions and values to be input into the model, and the demonstrated sensitivity of the model outputs to variation of these input parameters, combine to create a clear opportunity for the BOCs to use the SCIS/SCM-based costing process as a means of supporting independently derived, non "cost-based" rates. The Andersen Report's conclusion that SCIS accurately calculates investment outputs based on a given set of user-defined inputs does not mitigate this opportunity. If the Commission allows the BOCs to develop cost support for BSE rates by utilizing a SCIS-based process - a process which the Andersen Report describes as granting the BOCs considerable choice regarding selection of the input parameters that are shown in each sensitivity analysis to significantly affect the output - it will effectively be granting the BOCs the "costing flexibility" needed to support a strategically-determined rate structure. In such an environment, ONA would provide no protection against BOC monopoly abuse.

IV. CONCLUSION

The BOCs have failed to demonstrate, as required by law and the Commission's Order instituting this investigation, that the rates set forth in the ONA access tariffs which are the subject of this investigation are just and reasonable. MCI urges the Commission to act promptly to ensure that the BOC ONA tariffs are brought into compliance with the requirements of the law.

Respectfully submitted,

MCI TELECOMMUNICATIONS CORPORATION

By: Larry A. Blosser

Larry A. Blosser
Frank W. Krogh
Donald J. Elardo
1801 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 887-2727

Its Attorneys

Mark T. Bryant
Don J. Wood
Andrew L. Regitsky

Its Analysts

Dated: October 16, 1992

CERTIFICATE OF SERVICE

I, Vernell V. Garey, do hereby certify that on this 16th day of October, 1992, copies of the foregoing **"OPPOSITION TO DIRECT CASES"** in CC Docket 92-91 were served by first-class mail, postage prepaid, unless otherwise indicated, upon the parties on the attached list.

*Hand Delivered

Vernell V. Garey

Cheryl Tritt, Esq.*
Chief, Common Carrier
Bureau
Federal Communications
Commission
1919 M Street N.W.
Washington, D.C. 20554

Gregory Vogt, Esq.*
Chief, Tariff Division
Common Carrier Bureau
Federal Communications
Commission
1919 M Street N.W.
Washington, D.C. 20554

Stan Wiggins, Esq.*
Senior Attorney
Tariff Division
Common Carrier Bureau
Federal Communications
Commission
1919 M Street N.W.
Washington, D.C. 20554

James F. Britt
Executive Director
Bell Communications Research
LCC 2E-243
290 West Mt. Pleasant Avenue
Livingston, NJ 07039

Anna Lim
Counsel, Federal Relations
U S WEST Communications, Inc.
1020 19th Street, N.W.
Suite 700
Washington, DC 20036

James S. Blaszak
Charles C. Hunter
Gardner, Carton & Douglas
1301 K Street, N.W.
Suite 900 - East Tower
Washington, DC 20005

J. Scott Nicholls
Roy L. Morris
Allnet Communications Services,
Inc.
1990 M Street, N.W.
Suite 500
Washington, DC 20036

Richard E. Wiley
Michael Yourshaw
William B. Baker
Wiley, Rein & Fielding
1776 K Street, N.W.
Washington, DC 20006
Counsel for American
Newspaper Publishers Association

Francine J. Berry
David P. Condit
Peter H. Jacoby
Edward A. Ryan
American Telephone & Telegraph Co.
295 North Maple Avenue
Room 3244J1
Basking Ridge, NJ 07920

Richard E. Wiley
Robert J. Butler
Wiley, Rein & Fielding
1776 K Street, N.W.
Washington, DC 20006

Daryl L. Avery
Peter Wolfe
Public Service Commission
of the District of Columbia
450 Fifth Street, N.W.
Washington, DC 20001

Michael J. Ettner
General Services Administration
Personal Property Division
18th & F Streets, N.W.
Room 4002
Washington, D.C. 20405

Leon M. Kestenbaum
US Sprint Communications
Company Limited Partnership
1850 M Street, N.W.
Suite 1110
Washington, DC 20036

Peter A. Rohrbach
Karis A. Hastings
Hogan & Hartson
555 13th Street, N.W.
Washington, D.C. 20004

Randall B. Lowe
John E. Hoover
Michael R. Carper
Jones, Day, Reavis & Pogue
1450 G Street, N.W.
Washington, DC 20005
Counsel for Metromedia
Communications Corporation

Paul DeJongh
Northern Telecom, Inc.
P.O. Box 13010
Research Triangle
Park, NC 27709-3010

L. Michelle Boeckman
730 International Parkway
Richardson, TX 75081
Counsel for Ericsson Network
Systems

Albert Halprin
Stephen L. Goodman
Halprin, Mendelsohn &
Goodman
1301 K Street N.W.
Suite 1020 East
Washington, D.C. 20005

Jo Ann Goodard Riley
Director
Pacific Telesis
Federal Regulatory Relations
1275 Pennsylvania Avenue, N. W.
Suite 400
Washington, D.C. 20004

Downtown Copy Center *
1919 M Street, N.W., Rm 246
Washington, D.C. 20554

Floyd S. Keene
Attorney for Ameritech
2000 West Ameritech Center Dr.
Rm. 4H64
Hoffman Estates, IL 60196-1025

James R. Young
Attorney for Bell Atlantic
1710 H Street, N.W.
Washington, D.C. 20006

William B. Barfield
Attorney for BellSouth
1155 Peachtree St., N.E., Rm. 1800
Atlanta, GA 30367

Mary McDermott
Attorney for NYNEX
120 Bloomingdale Road
White Plains, NY 10605

William C. Sullivan
Attorney for Southwestern Bell
1010 Pine St., Rm. 2305
St. Louis, MO 63101